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REPORT

From:	Presidency
To:	Permanent Representatives Committee (Part 2)
Subject:	Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism - state of play

1. The Commission proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism¹ (CBAM) was published on 14 July 2021 as part of the 'Fit for 55' package.
2. On 15 March 2022, the Council of the EU (ECOFIN) reached agreement on a general approach on the draft CBAM Regulation (doc. ST 7226/22). The Council also took note of the Annex to doc. ST 6978/22 and confirmed that work on the two elements set out in point one of that Annex needed to have progressed sufficiently before negotiations with the European Parliament on the CBAM Regulation could begin. These two issues, not covered by the CBAM Regulation, are of significance to the implementation of the CBAM:

¹ ST 10871/21 + ADD 1 to 6; (2021/0214 (COD)).

- (a) the rate at which the obligation to surrender CBAM certificates becomes more extensive under Article 31 of the draft CBAM Regulation is determined by the rate at which free allowances are allocated to industry sectors covered by the CBAM, established by the EU Emissions Trading System Directive;
 - (b) the issue of limiting potential carbon leakage from exports calls for appropriate solutions to ensure economic efficiency, environmental integrity and WTO compatibility.
- 3. Furthermore, in point two of that Annex, the Council recalled that the Commission put forward proposals for own resources based inter alia on revenue from the sale of CBAM certificates (doc. ST 15260/21). In point three, the Council also noted that the establishment of the CBAM called for the development of bilateral, multilateral and international cooperation with third countries in order to promote the implementation of ambitious climate policies.
- 4. Since the Council (Ecofin) meeting on 15 March 2022, work on the matters set out in point 1 of the Annex has progressed to a degree that permits to begin negotiations with the European Parliament on the CBAM Regulation.
- 5. On 28 June 2022, the Council (Environment) reached agreement on a general approach on the draft Directive amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union (EU ETS; doc. ST 10796/22).
- 6. Among other issues, the general approach reached by the Council on the EU ETS Directive addresses the duration of the phase-out period for free allocations to sectors covered by the CBAM, and identifies provisions on carbon leakage in relation to exports. It sets out the rate at which free allowances are allocated to industry sectors covered by the CBAM, over a 10-year period, with a progressive reduction of free allowances, slower at the beginning of the period, and faster towards the end (Article 10a(1a)). This, in turn, automatically determines the rate at which the obligation to surrender CBAM certificates becomes more extensive under Article 31 of the draft CBAM Regulation.

7. The Council general approach on the text of the draft EU ETS Directive also provides more detail on the ‘special attention’ to be paid in the context of the Innovation Fund to CBAM sectors, setting out the aim that over the 2021-2030 period, projects in those sectors are awarded a significant share of the equivalence in financial value of CBAM sectors-related allowances, and indicating that the Commission may launch before 2027 calls for proposals dedicated to the sectors (Article 10a(8)).
8. Finally, it expands on the review clause of the ETS in relation to CBAM sector (Article 30), providing that the measures applicable to CBAM sectors shall be kept under review in light of the application of the CBAM Regulation, and that before 1 January 2026 and every two years thereafter as part of its reports to the European Parliament and the Council pursuant to Article 30 of the CBAM regulation, the Commission shall assess the impact of the mechanism on the risk of carbon leakage, including in relation to exports and make legislative proposals as appropriate.
9. On 22 June 2022, the European Parliament (EP) adopted a number of amendments to the CBAM legislative proposal adopted by the European Commission, which constitute the position of the EP in the forthcoming negotiations with the Council on this file.²
10. The Ad Hoc Working Party on the Carbon Border Adjustment Mechanism (“AHWP CBAM”)³ already took stock of the abovementioned recent developments and has begun its work on the analysis of the EP position on the CBAM Regulation. The attention of the Presidency was drawn to a number of areas where the EP position is differing from the general approach of the Council, for example, the scope and the pace of phase-in of CBAM, rules on governance and degree of centralisation, role of national authorities and of the European Commission or use of CBAM revenues.

² https://www.europarl.europa.eu/doceo/document/TA-9-2022-0248_EN.html

³ Established by the Committee of Permanent Representatives (Part 2), with the objective to conduct, in accordance with its mandate (doc. ST 10846/21) the preparatory work related to the design of CBAM and negotiations on this legislative proposal and to efficiently address the cross-sectoral subject matters covered by this dossier.

11. It has also been recalled that the activities of the AHWP CBAM shall be without prejudice to the work outside the scope of the proposal for a Regulation establishing CBAM, carried out in other sectorial preparatory bodies of the Council, which shall remain responsible for distinct sector-specific legislative and non-legislative files⁴.
12. Moreover, it is of particular importance for the delegations to monitor, to discuss, further clarify and agree, by the end of negotiations on this dossier:
- the relevant operational aspects of the applicability of CBAM towards trading partners of the Union, in particular those that have ambitious and progressive environmental policies in place;
 - the criteria, as part of the essential characteristics of the CBAM Regulation, for any exemptions from the CBAM, and
 - the principles under which the CBAM will correlate with ongoing international work on the ‘climate club’, as well as addressing risks of carbon leakage for emission intensive goods, while complying with international rules.

In order to facilitate the assessment by delegations, the European Commission should regularly update on all contacts with relevant non-EU countries relating to the ongoing work on CBAM in the EU.

13. In preparation of and during the negotiations with the European Parliament, the Presidency will take into account the issues outlined above, and intends to follow the Council position (general approach), bearing in mind the comments made by the delegations, in relation to the EP position, as appropriate.
14. The Presidency therefore wishes to report to the Committee of Permanent Representatives on the above developments and on its readiness to make progress in the interinstitutional negotiations (‘trilogues’), and to suggest that the Committee of Permanent Representatives takes note of the state of play on this dossier.

⁴ E. g. the Working Party on Own Resources, Working Party on Customs Union, Working Party on the Environment, Trade Policy Committee, Working Party on Tax Questions, (Fiscal) Counsellors/Attachés (A.18), etc.